DEPARTMENT OF AUDITS AND ACCOUNTS

270 Washington Street, S.W., Suite 4-114
Atlanta, Georgia 30334-8400

RUSSELL W. HINTON
STATE AUDITOR
(404) 656-2174

March 19, 2012

Honorable Mickey Channell, Chairman
House Ways and Means Committee
State Capitol, Room 133
Atlanta, Georgia 30334

SUBJECT: Fiscal Note
House Bill 386 Substitute
(LC 34 3477S)

Dear Chairman Channell:

The Georgia State University Fiscal Research Center provided the following narrative on the revenue impact of this bill:

This legislation proposes changes to multiple provisions in Georgia's tax code.

Part I – Title Fee

This section would change state and local taxation of motor vehicles. First, the state and local sales tax currently levied on non-casual sale vehicles is eliminated as of March 1, 2013. However, the use tax on leased vehicles would continue. Second, the state and local property tax on motor vehicles, currently levied at 40 percent of assessed value is also eliminated on vehicles titled beginning on March 1, 2013. Lastly, a combined state and local 6.5 percent title fee is imposed on the value of all motor vehicles, net of any trade-in value, titled in Georgia on or after March 1, 2013. This would include new and leased vehicles, used vehicles purchased through a dealer or through a casual sale transaction, and out-of-state vehicles titled in Georgia. This rate would increase to 6.75 percent on January 1, 2014 and 7.00 percent on January 1, 2015. This title fee revenue would be shared among the state and local governments by formula.

In addition, this section provides that local governments will receive a combination of property tax from vehicles that have not yet phased out of the property tax system and title fee revenue that meets a minimum level. This level is computed as $1,027 million increased by 2% for each year subsequent to 2013. The table below lists the actual property and sales tax revenues received by local governments and then compares the estimated revenue received under the title fee system to the minimum guarantee.

	Actuals		
Actuals	2008	2009	2010
Total Local Sales and Property Tax Revenues ($M)	1027	1016	988

Estimates	Estimates 2014	2015
Local Government Minimum Revenue Guarantee ($M)	1020	1040
Estimated Local Property Tax and Title Fee Revenue ($M)	1173	1156

The estimated change in state revenues from this section are $72 million in FY 2013, $203 million in FY 2014 and $228 million in FY 2015. The change in local government revenues would be $58 million in FY 2013, -$45 million in FY 2014, and -$151 million in FY 2015.

Part II

Section 2-1 – Personal Exemption for Married Filers

The proposed bill would increase the personal exemption amounts for individual income tax returns of married filers by $2,000 for those whose filing status is Married Filing Joint (from $2,700 each for the primary taxpayer and spouse to $3,700 each) and by $1,000 for those whose filing status is Married Filing Separate.

The effect of these changes is estimated using a micro-simulation model and tax year 2009 individual returns data from the Department of Revenue for full-year resident filers to recalculate 2009 tax liabilities after giving effect to the higher exemption amounts for married filers. The result of the simulated tax change is a reduction in 2009 tax liability for full-year resident, married filers of about $130.7 million. This number is then grossed up to include the estimated effect on part-year and non-resident filers, who accounted for about 10 percent of all married filers. The benefit to part-year and non-resident filers is a function of the ratio of Georgia to non-Georgia income (Schedule 3, line 9), which averages about 0.4 for those who are married. The resulting, grossed up estimate of the effect on 2009 tax liabilities is $136.6 million.

The 2009 simulated tax liability change is projected forward to FY2013-2015 based on the projected growth of the married population, using a range of 1.5 percent to 2.0 percent per annum. Given an effective date for this increased exemption of January 1, 2013, the FY2013 estimate reflects the effect on withholding and estimated tax payments applicable to calendar 2013 that are expected to be collected by the June 30 fiscal year end, assumed to be about 5/12 of the full year effect. Estimated revenue effects are as follows:

Change in State Revenues ($millions)	**FY 2013**	**FY 2014**	**FY 2015**
1.5% growth	($60.0)	($146.0)	($148.2)
2.0% growth	($61.0)	($149.3)	($152.3)

Section 2-2 – Retirement Income Exclusion

The proposed bill would cap the retirement income exclusion for filers age 65 or older at $65,000. Under current law, the maximum exclusion amount was scheduled to rise from $65,000 in calendar 2012 to $100,000 in 2013, $150,000 in 2014, and $200,000 in 2015 for age 65 and older filers. Beginning in calendar 2016, the retirement income exclusion would be unlimited for age 65 and older filers.

To estimate the savings from imposing the proposed cap, it is first necessary to estimate the tax expenditure under current law and then compare that with the estimated tax expenditure under the new cap. This is done by simulating the changes using tax year 2009 tax return data from the Department of Revenue. 2009 is the latest year of data available and the exclusion cap in effect for that year was $35,000 for filers age 62 or older. The current law increases in the exclusion limit apply only to filers at least age 65, but the data do not include data on the age of the filer. In addition, the exclusion only applies to defined "retirement income", which does not include earned income such as wages, salaries, or business income. The data from DOR also do not include the sources or types of income. It is therefore necessary to estimate effects treating all filers claiming the $35,000 maximum exclusion in 2009 as if they were 65 or older and treating all income above that cap as if it were eligible retirement income, and then make adjustments to the simulation result for age 62-64 filers and earned income.

To adjust for filers age 62-64, whose retirement exclusion limit remains at $35,000 under current law, it is assumed that 20 percent of filers claiming the retirement exclusion are at least age 62, but not yet 65. To adjust for income in excess of the $35,000 cap in effect in 2009 that is not eligible for exclusion at the higher caps, it is assumed that 17.5 percent of such income is ineligible, earned income. These assumptions are based on age and sources of income statistics from the Internal Revenue Service. The resulting estimates of the revenue gains from imposing the $65,000 cap, compared to current law, are as follows:

Change in State Revenues
$65,000 Exclusion Cap vs. Current Law

($ millions)	FY2013	FY2014	FY2015
Before Adjustments for Age and Earned Income	$20.8	$49.1	$68.7
After Adjustments for Age and Earned Income	**$13.8**	**$32.5**	**$45.4**

Part III – Conservation Easement
This legislation would effectively reduce the cap of the conservation easement credit to $500,000 as of January 1, 2013. The revenue impact is an increase in revenue of $2.97 million in FY2013, $6.09 in FY2014, and $6.40 in FY2015.

Data from the Department of Revenue were used to estimate the impact of this legislation. DOR reports the amount of credit generated by calendar year. Those amounts are as follows:

2006	2007	2008	2009	2010 (not yet complete)
$4,909,784.00	$9,854,474.47	$13,628,967.00	$18,466,832.00	$14,387,086.00

The actual amount of credit utilized each year is some fraction of the amount generated. Taxpayers who are not able to use the full amount of the credit in a given year may carry the unused amount forward. Over time, it is likely that most of the credit will be used. The credit became transferable beginning in 2012. It is expected that the transferability will increase the number of taxpayers applying for the credit and the rate of utilization.

The current revenue estimate conservatively assumes the following:

1. 2010 data are used as the base year. As DOR data are not complete for 2010, this is a lower bound estimate of the total credits generated.
2. The transferability from 2012 on may increase the level of credits generated. In the revenue estimate, the forecasted credits generated grow by 10 percent in the early years and 5 percent in the later years. This is conservative growth based on historical growth and the fact that transferability begins in 2012.

The revenue estimate assumes that by 2013, the credits generated are fully utilized.

Part IV – Film Sales Tax Exemption
This part would eliminate the existing sales tax exemption for film production activities. This provision would be effective July 1, 2012. The change in state revenues due to this provision would be $11.0 million in FY 2013, $11.9 million in FY 2014 and $12.9 million in FY 2015. The change in local revenues due to this provision would be $7.7 million in FY 2013, $8.3 million in FY 2014, and $9.0 million in FY 2015.

Part V - Other Sales Tax Exemptions
Section 5-2 Manufacturing Sales Tax
This section codifies current Department of Revenue regulations with respect to sales tax exemptions for manufacturing activities. It also has several new provisions. First, it would phase out the current sales tax on energy used in manufacturing, mining and newspaper publishing except for any local sales tax for education. The phase out would last for four years beginning January 1 2013. Second, it would eliminate the current exemption on energy used in agriculture, except for any local sales tax on education. Third, it would allow counties to impose a 2% excise tax on energy used in manufacturing. This excise tax would be phased in over four years, effectively allowing a county to replace the revenues lost due to the phase out of local sales taxes, excluding the local sales tax for education. Fifth, the sales tax exemption would be fully implemented immediately for competitive projects determined to be projects of regional significance.

To estimate the revenue loss from the phase in exemption on energy, U.S. Energy Information Administration data on industrial sector energy use in Georgia was used to provide total industrial energy consumption by fuel. Recent price data was applied to this consumption data to determine an overall weighted average price of energy in the industrial sector and current expenditure level. The share of Georgia GDP accounted for by manufacturing and mining relative to the overall industrial sector in Georgia was used to determine the share of total industrial expenditures by industry sector. Expenditures are projected to grow 3% per year over time.

The exemption for energy in manufacturing begins January 1, 2013 and exempts 1/4 of the expenditure by exempt users. This exemption increases by 1/4 on each subsequent January 1 until reaching the full exemption.

The revenue change would be -$18.0 million in FY 2013, -$55.1 million in FY 2014 and -$94.3 million in FY 2015.

The impact of this phase-in on local government is uncertain since the exemption does not apply to the local sales tax for education and any potential revenue loss to local governments from the manufacturing exemption may be replaced by the local excise tax option. Thus, no revenue change estimate was developed for local governments.

In addition, the Department of Economic Development provided estimates regarding the amount of revenue change associated with discretionary use of exemption prior to the completion of the phase-in. The estimated sales tax revenue change for eligible projects is -$3.3 million in FY 2013. This is expected to grow to -$3.4 million in FY 2014 and -$3.5 million in FY 2015. The change in local sales tax revenues would be -$2.3 million in FY 2013, -$2.4 million in FY 2014, and -$2.5 million in FY 2015.

Section 5-3 – Agriculture Exemption
This section broadens the existing sales tax exemptions for agriculture producers to exempt a wider array of inputs including energy. All eligible expenditures would be fully exempt from sales tax effective January 1, 2013. The change in state revenues is estimated to be -$8.3 million in FY 2013, -$16.8 million in FY 2014 and -$17.3 million in FY 2015. The change in local revenue is estimated to be -$5.8 million in FY 2013, -$11.7 million in FY 2014, and -$12.1 million in FY 2015.

Section 5.5 – Construction Materials Exemption
This section provides for an exemption from sales tax for construction materials used in a project of regional significance. The commissioner of the Department of Economic Development would establish guidelines for determining if a project meets the standard of regional significance. This section would be effective January 1, 2012 and terminate on June 30, 2014.

The Department of Economic Development provided estimates on the expected use of this discretionary authority. These estimates are a revenue change of -$21.0 million in each fiscal year during which the exemption is in place. The change in local sales tax revenues associated with this estimate is -$14.7 million each fiscal year.

Section 5.6 – Jet Fuel Exemption
This section would alter the sales and use taxation of jet fuel for commercial use. Currently, jet fuel is taxed at a 4% state sales tax rate. This section would exempt 1% of the total 4% rate for commercial sales and use of jet fuel. It would also terminate an existing sales tax provision which reduces state revenues by $10 million in FY 2013. This provision takes effect on July 1, 2012.

Industry sources estimate that approximately 695 million gallons of jet fuel are used per year at Georgia airports. The U.S. Energy Information Administration estimates that the spot price of jet fuel for the period from September 2, 2011 through March 9, 2012 averaged $3.033 per gallon. This is the Gulf Coast Region spot price. Prices in Georgia may be higher reflecting transportation costs to Georgia. However, no information was found on recent delivered prices in Georgia. Based on this data, annual expenditures on jet fuel in Georgia would total just over $2.1 billion. Thus, the 1% exemption would reduce state sales tax revenues by approximately $21.1 million. This would be expected to vary with jet fuel prices and with jet fuel consumption over time. Assuming a combined growth in prices and consumption of 3% per year, the change in state revenues would be -$11.1 million in FY 2013, -$21.7 million in FY 2014 and -$22.4 million in FY 2015. This section would not alter current local sales taxation of jet fuel.

Part VI – Sales and Use Taxation

Section 6.1 – E-fairness
This section updates sales and use tax provision to clarify the definition of dealer. Effectively, this definition would create nexus for purposes of sales tax to vendors that do not currently have nexus if they have affiliate relationships with in state sellers, provided that relationship has cumulative gross receipts from sales by the affiliate to customers in Georgia in excess of $10,000 over the last twelve months.

The provisions regarding the definition of dealer in the sales and use tax provisions will address a current gap in sales tax collections associated with remote and internet sales. States face limitations in their ability to collect sales and use tax that is due on a large portion of these sales. Out-of-state remote sellers without a physical presence in a state are not required to collect the tax that is due on sales to customers located in that state. While the customer still has a duty to remit the use tax on those sales, in practice these use taxes are seldom paid.

In recent years, several states have put in place laws that seek to close the compliance gap on these remote sales. In addition to better enforcing the current law and collecting more of the revenue already due, these laws are intended to balance the playing field for retailers that operate within the state and are required to collect the tax. The remote sellers gain a price advantage due to their ability to escape collecting the tax; this competitive advantage tends to reduce jobs and local sales and shift these to the out of state retailers.

The most direct effect of this legislation is to require remote sellers to collect sales tax if the remote seller has affiliates located in the state that sell through the remote seller's website that meet the gross revenue provision. This click-through nexus provision is premised on the fact that some very large internet sellers operate affiliate programs that allow small businesses to market and sell on the seller's website. These laws specify that an affiliate's presence in the state creates the legal obligation to collect sales taxes on all sales into that state.

In some cases, sellers have responded to these laws by terminating relationships with local affiliates, thereby retaining their right to not collect tax. Alternatively in some states such as Indiana, Tennessee and most recently Virginia, a retailer has then negotiated state specific agreements that the retailer would begin collecting sales tax in the future provided there is no obligation to collect taxes until a date certain. Another exception is New York where large retailers have retained their local affiliates and begun to collect sales tax. Concurrently, they are litigating the constitutionality of the law.

In FY 2010-11, New York collected a combined $100 million in state and local sales tax revenues due to this law. Approximately 50% or $50 million would be state revenue based on a 4% state sales tax rate and a 4.5% maximum local sales tax rate. Based on the relative levels of total personal income in New York and in Georgia and assuming similar buying behaviors, a click-through nexus law could generate as much as $18 million per year. This would likely grow at least 5% per year given recent growth rates in e-commerce. However, it is quite possible, even likely, that the largest remote sellers would terminate their affiliate relationships. In this case, incremental revenue would be negligible. This section would be effective October 1, 2012. Thus the revenue impact could range as reflected in the table on the next page.

	FY 2013	FY 2014 ($m)	FY 2015
Sellers Terminate Affillates	**0**	**0**	**0**
Sellers Collect Sales Tax			
State Revenue Change	**13.5**	**18.9**	**19.8**
Local Revenue Change	**9.4**	**13.2**	**13.8**

Section 6-2 – Sales Tax Holidays
This section would reinstitute the sales tax holidays last held in 2009. These would occur in August of 2012 and 2013 for back-to-school items and in October of 2012 and 2013 for energy efficient goods.

Since the initial estimates were developed for the sales tax holiday, the Fiscal Research Center has updated its methodology and the new methodology indicates an increased revenue impact for state and local governments. It is estimated that the change in state revenues from a July or August sales tax holiday would range between -$36.7 million and -$49.8 million in FY 2013 and -$38.7 million and -$52.5 million in FY 2014. The revenue change for local governments would range between -$25.7 million and -$34.9 million in FY 2013 and -$27.1 million and -$36.8 million in FY 2014.

These estimates represent an upper bound in the sense that they do not account for structural changes to the holidays. First, the back-to-school holiday will be two days rather than four days long. Second, the price limit on computers and accessories was lowered to $1,000 from $1,500. In practice, these changes are expected to have little impact on the revenue loss. First, research indicates that the preponderance of sales of computers and computer accessories will fall below the $1,000 threshold in price. Similarly, studies have shown that expanding the length of a holiday by one day has little impact on the overall revenue loss from the holiday. Strictly extrapolating from the analysis of updated methodology in FRC Report No. 228, the likely combined effect of the reduced days and the lower price limit on computer-related items would be a reduction in the state revenue loss on the order of $4.4 million relative to the base estimate of $36.7 million to $49.8 million. The table below summarizes the estimates adjusting for these structural changes.

The impact from the energy efficient sales tax is updated from the estimate prepared for the proposed energy sales tax holiday for October of 2010. Extrapolating from this estimate, the revenue change is estimated at -$0.53 million in FY 2013 and -$0.56 million in FY 2014. The local sales tax impact is expected to be -$0.37 million in FY 2013 and -$0.39 million in FY 2014. The table below summarizes these estimates. The mid-point of the estimates for the back-to-school holiday are used in the summary table at the end of this note.

	FY 2013	FY 2014
Back to School Holiday		
Updated Methodology with Revised Holiday Structure		
State Revenue Change - High	-32.3	-34.3
State Revenue Change - Low	-45.4	-48.1
Local Revenue Change High	-22.6	-24.0
Local Revenue Change Low	-31.8	-33.7
Energy Efficient Holiday		
State Revenue Change	-0.53	-0.56
Local Revenue Change	-0.37	-0.39

Summary

The tables on the next page summarize the revenue changes for state and local governments by provision.

Summary of Revenue Changes

State Revenue Changes - $Millions	FY 2013	FY 2014	FY 2015	Total
Title Fee	72.0	203.0	228.0	503.0
Personal Exemption for Married Filers (Jan 1 2013 / 2% Growth)	-61.0	-149.3	-152.3	-362.6
Cap Retirement Exclusion (adjusted for age and earned income)	13.8	32.5	45.4	91.7
Conservation Easement	2.97	6.09	6.4	15.5
Film Sales Tax Exemption	11.0	11.9	12.9	35.8
Energy Phase Out	-18.0	-55.1	-94.3	-167.4
Energy Discretionary Authority	-3.3	-3.4	-3.5	-10.2
Agriculture Exemption	-8.3	-16.8	-17.3	-42.4
Construction Materials Exemption	-21.0	-21.0		-42.0
Jet Fuel Exemption	-11.1	-21.7	-22.4	-55.2
E-fairness (Sellers Collect)	13.5	18.9	19.8	52.2
Sales Tax Holiday	-39.38	-41.76		-81.1
Total	-48.8	-36.7	22.7	-62.8

Summary of Revenue Changes

Local Government Revenue changes - $Millions	FY 2013	FY 2014	FY 2015	Total
Title Fee	58.0	-45.0	-151.0	-138.0
Personal Exemption for Married Filers (Jan 1 2013 / 2% Growth)	0.0	0.0	0.0	0.0
Cap Retirement Exclusion (adjusted for age and earned income)	0.0	0.0	0.0	0.0
Conservation Easement	0.0	0.0	0.0	0.0
Film Sales Tax Exemption	7.7	8.3	9.0	25.0
Energy Phase Out				0.0
Energy Discretionary Authority	-2.3	-2.4	-2.5	-7.2
Agriculture Exemption	-5.8	-11.7	-12.1	-29.6
Construction Materials Exemption	-14.7	-14.7		-29.4
Jet Fuel Exemption	0.0	0.0	0.0	0.0
E-fairness (Sellers Collect)	9.4	13.2	13.8	36.4
Sales Tax Holiday	-27.57	-29.23	0.0	-56.8
Total	24.7	-81.5	-142.8	-199.6

Sincerely,

Russell W. Hinton (attest Edward Blake)

Russell W. Hinton
State Auditor

Debbie Dlugolenski Alford

Debbie Dlugolenski Alford, Director
Office of Planning and Budget

RWH/DDA/eb/bb